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International Economic & Energy Weekly

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19 October 1984

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19 October 1984

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International
Economic & Energy
Weekly 25X1

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International Economic & Energy Weekly

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Synopsis

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1 **Perspective—*The Latest Oil Price Declines***

The recent decision by the United Kingdom to reduce its official oil prices by about $1.35 per barrel—on the heels of a decision by Norway to reduce its official prices—raises the possibility that oil prices could begin a general slide.

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15 **Lower Excess Oil-Productive Capacity Outside the Persian Gulf** 25X1

Surplus capacity outside the Persian Gulf in the fourth quarter of 1984 will fall to about 2.3 million b/d—less than 20 percent of Gulf output. The availability of considerable excess capacity in Saudi Arabia and the levels of consuming countries' stockpiles should enable the market to cope with all but the most severe disruptions. 25X1

19 **Tunisia: Dealing With Disparities** 25X1

A prolonged period of economic development during the 1970s and the highest adult literacy rate in North Africa—62.5 percent—created rising popular expectations that Tunis has been increasingly unable to satisfy. 25X1

23 **India: Gandhi's Election-Year Economics** 25X1

Prime Minister Gandhi is trying to keep economic issues from becoming a major issue in the upcoming national elections. Her goals, in our judgment, are to hold down prices of key commodities and to limit unemployment in the preelection months. 25X1

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[redacted]

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International Economic & Energy Weekly [redacted]

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19 October 1984

Perspective

The Latest Oil Price Declines

The recent decision by the United Kingdom to reduce its official oil prices by about $1.35 per barrel—on the heels of a decision by Norway to reduce its official prices—raises the possibility that oil prices could begin a general slide. London's decision could lead Nigeria—which produces similar-quality crude—to lower its official prices also. A price reduction by Nigeria would threaten the existing OPEC price structure, particularly since the United Arab Emirates already threatened to reduce its prices before the British and Norwegian cuts. At a minimum, OPEC also will need a rapid rebound in oil demand in the fourth quarter to avoid a further unraveling of prices. [redacted] 25X1

The amounts of the Norwegian and British cuts are tied to spot oil prices, which have been weak since midsummer. Spot oil prices declined precipitately in late July and early August as oil companies chose to liquidate excess inventories and OPEC continued to produce at high levels in June and early July. Despite severe market pressures, the British and most other producers, however, managed to hold the line on prices. London's request that companies avoid further pressure on BNOC—the UK's national oil company—combined with a significant reduction in Saudi and other OPEC producers' output allowed spot oil prices to firm slightly in September and early October. [redacted] 25X1

Despite OPEC oil production of only 16.2 million barrels per day (b/d) in August and September, however, spot oil prices have remained about $1.50 to $2.00 per barrel below official levels. The ready availability of oil and the difference between spot and official prices encouraged many buyers to reduce contract purchases with the United Kingdom and several OPEC countries. As buyers walked away from contracts, the volume of oil traded at other than official prices escalated, compounding price weakness. One industry source estimates that in recent weeks as much as 50 percent of oil trade has been at less than official prices—including spot crude deals, refined products, barter deals, and sales of natural gas liquids. As the volume of spot oil transactions continues to increase, spot oil prices have become an even more significant barometer of oil prices. [redacted] 25X1

The British reduction puts substantial pressure on OPEC; a similar—although not identical—sequence of events led to OPEC's oil price reduction of $5 per barrel in early 1983. As we see it, OPEC must act quickly if it is to be successful in forestalling an unraveling of oil prices, particularly since many industry purchasers probably will try to delay normal seasonal purchases until the trend in prices becomes clearer. A number of scenarios are possible:

- OPEC could choose to hold the line on oil prices either in a formal OPEC meeting or as the result of informal communication among members. Press reporting indicates that the OPEC Secretariat cabled all members, strongly encouraging that a formal meeting be held. The Saudis also are reportedly supporting a meeting within the next week or 10 days. This approach probably would be appealing to a number of OPEC members—such as Iran, Algeria, and Kuwait—but we believe it would require several OPEC members besides Saudi Arabia to reduce oil output. Saudi flexibility to further reduce its production is limited, since we estimate that output was 4 million b/d at the end of September. OPEC members also would have to abandon effective price discounting through barter deals or other mechanisms.

- Unilateral decisions by OPEC members to reduce oil prices are also possible, particularly if other non-OPEC producers act quickly to lower their prices. Last year, for example, Nigeria followed a British price drop by an even larger price cut, forcing the formal OPEC price reduction in March 1983. A decision by Nigeria to reduce prices would have direct repercussions on the many other OPEC members also producing primarily light crudes.

- OPEC could agree to again reduce official oil prices. Saudi Arabia would play the crucial role in such a scenario. If OPEC opts to reduce the benchmark oil price, we would expect the reduction to be more sizable than the recent British price cut. OPEC could also choose to hold more serious discussions on the issue of oil price differentials.

OPEC's approach in dealing with the pressure on oil prices will depend in part on whether the organization still expects—as do most industry sources—the increase in oil demand in the fourth quarter to materialize.

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Briefs

Energy

OPEC Production Update

OPEC production in September averaged 16.2 million barrels per day (b/d), matching August's level. Nigeria's production registered the sharpest gain as Lagos's price incentives to equity producers spurred liftings. The Nigerian increase was apparently accommodated by the continuing slide in Saudi output, which fell to its lowest monthly average in 18 months. Iranian production rose slightly from August's dramatically low level, despite three tanker attacks during the month. 25X1

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OPEC: Crude Oil Production [a] *Million b/*

	1984 Quota	First Half 1984	July	August	September
Total	**17.5**	**18.3**	**17.8**	**16.2**	**16.2**
Algeria	0.725	0.7	0.7	0.6	0.7
Ecuador	0.2	0.2	0.2	0.2	0.2
Gabon	0.15	0.2	0.2	0.2	0.2
Indonesia	1.3	1.5	1.4	1.3	1.3
Iran	2.4	2.3	2.5	1.8	2.0
Iraq	1.2	1.1	1.2	1.2	1.2
Kuwait	1.05	1.0	0.8	1.0	0.9
Libya	1.1	1.2	1.1	1.0	1.0
Neutral Zone [b]		0.5	0.4	0.5	0.4
Nigeria	1.3	1.4	1.1	1.1	1.4
Qatar	0.3	0.4	0.4	0.4	0.4
Saudi Arabia [c]	5.0	4.9	4.5	4.0	3.6
UAE	1.1	1.3	1.3	1.1	1.1
Venezuela	1.675	1.7	1.8	1.8	1.8

[a] Preliminary.
[b] Neutral Zone production is shared equally between Saudi Arabia and Kuwait and is included in each country's production quota.
[c] Saudi Arabia has no formal quota; it acts as swing producer to meet market requirements.

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Brazil's Falling Oil Imports

Brazil's oil import bill will drop from $7.8 billion in 1983 to an estimated $6. billion this year as both volume and prices decline. Oil import volume has fallen because of rapid growth in domestic production from 340,000 barrels per day (b/d) last year to about 480,000 b/d in 1984 and ongoing energy

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substitution programs primarily in hydroelectric power and alcohol fuels. Imports now account for less than one-half of oil needs, down from 80 percent in 1980. Together with a strong rebound in exports, the cut in oil imports will enable Brazil to achieve a record trade surplus this year of $11-12 billion and to rebuild its foreign exchange reserves to more than $7 billion. 25X1

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Denmark Becomes Natural Gas Exporter

Denmark became the newest European gas exporter when it officially inaugurated its gas grid this month. West Germany will buy 92 million cubic meters of Danish gas this year. Gas sales to Sweden will begin in June of 1985, and rise to 400 million cubic meters by 1989. Longer range ambitions include a northward extension of the gasline to Stockholm, capable of providing Sweden with 1.5 billion cubic meters annually. The prospect of future Danish gas supplies may have influenced the recent decision of the Swedish state natural gas supplier not to recommend a proposal to buy 1 billion cubic meters a year of Soviet gas. 25X1

Synthetic-Oil Refinery Opens in Alberta

Shell Canada late last month opened Scotford, the world's first refinery and petrochemical plant to specialize in the processing of synthetic crude oil. The complex, near Edmonton, will refine synthetic crude from the Alberta tar sands and produce styrene, a petrochemical used in synthetic rubber and plastics. Annual sales are expected to exceed $650 million, mostly from exports to the United States and Pacific Basin countries. Because the refinery can also process natural crude produced locally, it could be extremely important for future investment in Alberta's energy sector. Depending on the success of the project, Shell Canada reportedly will invest as much as $5 billion in the province between now and 1990. 25X1

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International Finance

East German Finances Improving

[redacted] 25X1

East Germany's borrowing prospects continue to improve. [redacted]

East Germany's improved credit standing reflects the regime's success in reducing its debt and increasing its reserves, as well as the greater confidence of Western bankers since the large loan guaranteed by Bonn last summer. East Berlin is likely to continue to try to lengthen the maturity structure of its debt and probably will use its strengthened position to seek still more favorable terms. [redacted] 25X1

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Global and Regional Developments

Record World Wheat Production

[redacted] 25X1

Global wheat production and exports this year are likely to reach record highs, despite poor crops in several exporting nations. World wheat production is likely to reach 500 million metric tons for the current market year—1 July 1984 to 30 June 1985—according to estimates by the US Department of Agriculture. Wheat exports are likely to be 105 million metric tons, also a new high. Recordbreaking wheat crops are expected for China, India, and the EC, with crops of 84 million, 45 million, and 74 million metric tons, respectively. [redacted] Bad weather in Canada, Argentina, and Australia, however, has dropped production by 20 percent from last year. As a result, wheat exports by Canada and Argentina will be substantially lower. Australia can use record carryover stocks to increase exports by almost 30 percent. [redacted]

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Proposed Belgian-Libyan Nuclear Cooperation

[redacted]

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The Belgian Cabinet next Friday will consider once again the proposed nuclear cooperation agreement with Libya [redacted] To stop the Libyan agreement, Brussels, at a minimum, would probably require renewed assurances that other West European firms would not supply

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equipment for the proposed nuclear power plant. Most Belgian Cabinet members, however, almost certainly are tempted by the lucrative project, which is tied to a broader economic agreement with Libya, and probably are still convinced that Belgium can guarantee responsible monitoring of Libyan activities. [redacted] 25X1

South Korean–Chinese Bilateral Trade Rebounds

[redacted]

Direct trade between South Korea and China is recovering following Beijing's effort, begun in late 1982, to enforce a ban on all bilateral trade. This action had only limited impact on the exchange of South Korean manufactures for Chinese energy products. Two-way trade dipped from $489 million in 1982 to $472 million last year as losses in South Korean sales offset a $23 million increase in imports of Chinese goods. Trade increased 58 percent in the first half of 1984, compared to the same period in 1983, to $334 million largely on the strength of a surge in South Korean exports. [redacted] 25X1 25X1

Despite North Korean irritation, Seoul and Beijing are increasing trade and other unofficial contacts. Recent commercial dealings include a visit by a Chinese trade official, a South Korean firm's participation in a trade show in China, [redacted] 25X1 25X1

National Developments

Developed Countries

[redacted] 25X1

[redacted] 25X1

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Japan To Export Large Trucks

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Faced with a stagnant domestic market for passenger cars and constraints in the growth of export markets, Japanese automakers this year have begun to export medium-to-heavy-duty trucks (9 to 13.5 tons) to the United States. Earlier this year, Isuzu Motors began exporting 4,000 of these trucks to a US automaker for sale under a US brand name. Hino Motors, an affiliate of Toyota, has begun to assemble a small number of similar trucks in a joint venture with a US company. In addition, Nissan Diesel Motors and Mitsubishi Motors are testing their trucks on US roads with an eye on exports. The Japanese are hoping that these trucks will provide efficient alternatives to heavy trucks for short-distance hauls. 25X1

Less Developed Countries

Record Israeli Inflation

Israeli consumer prices rose by a record 21.4 percent in September, bringing inflation during the first three quarters of this year to an annual rate of 438 percent. Officials had predicted an even larger price hike because of several large increases in the prices of government-controlled items and an 8.3-percent devaluation during the month. Under the terms of the cost-of-living agreement signed last May with the Histadrut, the large trade union organization, wages paid on 1 November will increase by 17.1 percent—80 percent of the rise in the consumer price index—which will also remove much of the sting.

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Insurance Claims Mount in Gulf War

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Claims settlements by Lloyd's of London—the world's leading syndicate of insurance underwriters—are climbing as the four-year-old Iran-Iraq war continues. A recent shipping industry press report indicates that settlements by Lloyd's affiliates now total $525 million. The major portion, $375 million, is attributable to the entrapment of 80 merchant ships in the Shatt al Arab waterway when the war erupted in September 1980. Claims resulting from attacks on commercial ships now total $100 million, while claims for lost oil cargoes and related salvage expenses total another $50 million. So far this year over 40 confirmed attacks on merchant ships have occurred, resulting in 24 deaths and 36 serious injuries. Despite the mounting claims, which contributed to Lloyd's first underwriting loss in 14 years, the London insurance market continues to write policies—albeit at higher premiums—for ships and cargoes venturing into the war-torn Persian Gulf. [redacted] 25X1

Nigeria's Deteriorating Investment Climate

[redacted]

The business environment for foreign firms in Nigeria continues to worsen, despite recent efforts by Head of State Buhari. Although Buhari has announced that the number of import licenses for raw materials will be increased in December to reduce shortages of manufactured goods, the US Embassy believes that new licenses may be delayed until early next year. 25X1 Such a delay could close several firms, many of which are now operating at only 30 percent of capacity. Moreover, chronic foreign-currency shortages render meaningless government requirements that commercial banks make available almost 60 percent of foreign exchange allocations for industrial raw materials, spare parts, and machinery. New foreign exchange regulations also have cut limits on repatriation of earnings by foreign firms from 50 to 25 percent. In addition, according to the US Embassy, Buhari is now seriously considering reneging on his decision to allow foreign agricultural investors to hold up to 80-percent ownership in joint agriculture and related businesses. [redacted] 25X1

Ambitious Indian Investment Plans

[redacted]

Nearly 2,000 large industrial and infrastructure projects, costing at least $145 billion, have been proposed or are under way, [redacted] 25X1 [redacted]. About 40 percent of the investment will be directed at 25X1 easing India's severe shortage of electricity. 25X1 Most of these large projects are in the public sector, but a few are among the 500 private industrial projects that received preliminary government approval during January-June 1984. This investment surge will provide a sizable stimulus to the economy over the next several years, even if private entrepreneurs withdraw from some proposed projects in areas of recent religious strife or if New Delhi postpones work on some government steel and power plants to conserve revenue and foreign exchange. [redacted] 25X1

Burma Halts Foreign Borrowing

[redacted]

Burma has decided to refuse additional foreign loans until its debt service capacity improves, according to the US Embassy. The voluntary curtailment of foreign borrowing applies even to concessional loans, which account for 80 25X1 percent of the country's $2.3 billion external debt. Rangoon acted after mounting repayment obligations and two years of depressed export earnings pushed its debt service ratio to 43 percent. An extended curb on foreign financing will delay major development projects, particularly the recently discovered natural gas deposits in the Gulf of Martaban. [redacted] 25X1

Thailand Hikes Tariffs

[redacted]

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Bangkok last week raised tariffs and import surcharges on luxury goods by roughly 10 percent. These measures were imposed after nine months of credit restriction failed to stem surging imports. Thailand's trade deficit hit a record $3.9 billion last year and totaled $1.7 billion in the first half of 1984. If import growth does not slow substantially in the next few months—which we believe unlikely unless the economy slows—the government is certain to consider other politically controversial trade restrictions. [redacted] 25X1

Communist

Soviet Views on Imports of US Petroleum Equipment

[redacted]

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A Soviet official has told US businessmen recently that new equipment orders for the Astrakhan, Tenghiz, and Karachaganak "sour" oil and gas projects will be worth about $1 billion each. According to the US Embassy in Moscow, the Soviet expressed interest in US equipment but considers it risky to order items of US origin. Several US firms that can supply equipment from overseas plants have been contacted, according to the official. While the official expressed willingness to accept direct bids, reporting for several months has indicated a general Soviet policy not to accept equipment from US sources. By using US firms only as subcontractors, Moscow probably believes it can hold the prime contractor responsible for any US export-control problems. [redacted] 25X1

[redacted]

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USSR Trade Surplus Up

[redacted]

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[redacted] the USSR registered a $3.4 billion trade surplus in the first six months of 1984, more than double that recorded in the same period of 1983. All the improvement came in trade with the developed West as a $2 billion deficit in first half 1983 shifted to an $800 million surplus in January-June 1984. This reversal was due largely to a sharp decline in imports of machinery and equipment and large-diameter pipe from West European and Japanese suppliers. While completion of deliveries for the export gas pipeline are partly responsible for this drop, imports of nonenergy capital goods are also being reduced. In contrast, Soviet surpluses with LDC and socialist trading partners declined by nearly 30 percent and 17 percent, respectively. The sharp reduction in Soviet exports to the LDCs probably reflects a decrease in 25X1 military deliveries. China accounted for the largest change in trade with socialist countries, as Soviet-PRC trade turnover more than tripled from $150 million in the first half of 1983 to about $500 million in the same period in 1984. 25X1

Soviet Trade Balances *Billion US$*

	January-June 1983			January-June 1984		
	Exports	Imports	Balance	Exports	Imports	Balance
Total	**45.3**	**43.8**	**1.5**	**45.2**	**41.8**	**3.4**
Developed West	12.6	14.6	−2.0	13.0	12.2	0.8
Less developed countries	6.8	5.1	1.7	5.8	4.6	1.2
Socialist	25.9	24.1	1.8	26.4	24.9	1.5
Eastern Europe	20.0	18.9	1.1	20.5	19.1	1.4
Other	5.9	5.1	0.8	6.0	5.8	0.2

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China's Plenum on Economic Reform

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The plenary session of the party Central Committee this week will mark a breakthrough for leaders allied to Deng Xiaoping who advocate a major relaxation of central economic controls. Policy changes slated for endorsement at the annual conference include a dramatic reduction in the number of agricultural and industrial commodities regulated by the national economic plan, a corresponding expansion of commodities subject to market regulation, and the relaxation of state pricing guidelines. 25X1

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In addition, the meeting is expected to mandate a substantial transfer of production and personnel control to enterprise managers. 25X1

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In introducing price reform, Deng is accepting some risks to attack the major impediment to reform. Speculation, hoarding, and inflation are among the problems Beijing may face in implementing this controversial measure. Prices of essential goods, such as coal and oil, will remain fixed, but prices for other items may float within set limits or be determined solely by market forces. 25X1

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Mexico: Debt Burden Still Heavy After Rescheduling [redacted]

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[redacted]

Mexico's agreement last month with its major creditors for a multiyear debt rescheduling does not solve Mexico's financial problems. The debt service burden will remain heavy and constrain imports and economic growth throughout this decade. The agreement, covering $48.5 billion of the $68 billion public-sector debt, reduces amortization payments during the next six years by stretching payments out through 1998 and lowering interest-rate spreads. It does not apply to the estimated $28 billion in private-sector debt. We believe Mexico City and its Bank Advisory Group will be able to sell the agreement to Mexico's other creditors, despite strong opposition from some regional and West European banks. [redacted]

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New Agreement for Public Debt

The rescheduling agreement was negotiated by the Mexican Finance Ministry and 14 lead banks representing Mexico's commercial creditors, of which there are more than 500. This Bank Advisory Group has seven US members, five West European members, and one Japanese and Mexican member. The key elements of the restructuring are:

- A 14-year repayment period, beginning in 1985.
- The dropping of the US prime rate option in favor of the lower London Interbank Offered Rate (LIBOR) as the baseline for calculating interest.
- An average risk premium of 1.125 percentage points above LIBOR, ranging from a low of 0.875 percentage point in 1985-86 to a high of 1.25 percentage points after 1990.
- A one-time option for non-US creditors to convert up to 50 percent of US dollar-denominated debt to the creditor's domestic currency.
- The IMF role will be limited to performing semiannual reviews of the Mexican economy that will be provided to the banks. [redacted]

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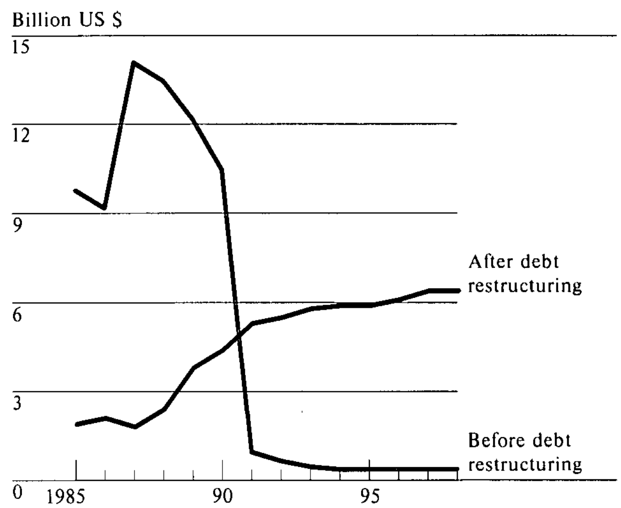
Mexico: Total Amortization Payments on Public-Sector External Debt



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[redacted]

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The proposed agreement will significantly reduce the government's amortization payments through 1990. According to figures released by Finance Minister Silva-Herzog, principal repayments will drop by an average of almost $9 billion annually in the 1985-90 period. In 1987, for example, the savings will be $12.3 billion and in 1990 they will be $6.1 billion. [redacted] 25X1

[redacted]

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[redacted]

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Alternative Repayment Scenarios

The rescheduling will give Mexico financial breathing room, but the debt-repayment burden will remain heavy. The rescheduling does not apply to the payment of interest, which would constitute roughly three-fourths of Mexico's total annual debt service. Fluctuations in world interest rates will determine the actual level of annual repayments. [redacted] 25X1

Barring a dramatic drop in interest rates, debt service payments will increase. If interest rates remain at current levels, principal and interest payments on public and private debts will rise from almost $18 billion in 1985 to over $24 billion in 1990. Even with a modest decline in interest rates, our optimistic case, payments still would reach $23 billion by 1990. Somewhat higher interest rates would boost repayments to $26 billion. [redacted] 25X1

Rescheduling Private Debt

A rescheduling of the $28 billion private debt would ease Mexico's debt service burden only slightly. If private debt is restructured along the lines of the public debt rescheduling, principal payments would decline by $2-3 billion annually. Even with such a restructuring, however, total debt service payments would exceed $20 billion in 1990. [redacted] 25X1

Negotiations on private debt restructuring will be time consuming and cumbersome, and probably never totally completed. Unlike public-sector debt, each loan must be handled on a case-by-case basis. We know of only one Mexican company, the large chemical conglomerate Cydsa, that has tentatively rescheduled its $139 million in external debt under the government's FICORCA program, which guarantees hard currency for private debt payments beginning in 1986. The government anticipates it will be able to reschedule the $12 billion in debt registered under FICORCA by late next year. The Cydsa rescheduling, which is in line with FICORCA's requirements, sets a precedent for other negotiations. The repayment period is eight years, with four years' grace. Cydsa negotiated an interest rate of 1.75 percentage points above LIBOR with its creditors. [redacted] 25X1

Details on the rescheduling of the estimated 57 percent of private debt not registered under FICORCA are extremely sketchy. Some of this

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debt may not require multiyear restructuring because it probably consists of supplier credits and other short-term instruments. In any event, we believe up to one-third of this debt may have already been written off by lenders as uncollectable. [redacted] 25X1

Implications of Rescheduling

The heavy debt service burden and banker resistance to additional reschedulings and new loans will constrain Mexico's import capacity and economic growth into the 1990s. We estimate that over the 1985-90 period Mexico's debt service would roughly consume its projected foreign exchange earnings from oil exports—about three-fourths of total merchandise exports. Under these circumstances, import capacity will be largely determined by nonoil export receipts, including earnings from tourism, and net new foreign loans from international banks. We expect that bankers will continue to limit new loans to Mexico and that net new borrowing will average about $3 billion annually in 1985-90. This compares with net borrowing of $21 billion in 1981.
[redacted] 25X1

[redacted] 25X1

Lower Excess Oil-Productive Capacity Outside the Persian Gulf [redacted]

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The underlying cushion of excess oil-productive capacity worldwide that is available to offset a Persian Gulf disruption is at present particularly thin. Recent price adjustments, unless they unravel the entire OPEC price structure, are not likely to change this situation. According to our projections, surplus capacity outside the Persian Gulf in the fourth quarter of 1984 will fall to about 2.3 million b/d—less than 20 percent of Gulf output. Moreover, reporting from US Embassy sources and companies operating in producing countries suggests that only about 1 million b/d of this could be available within 30 days of a decision to raise output—the remainder would take up to 90 days to return to production. Libya and Nigeria account for most of the surplus outside the Gulf that could be brought back on line in 30 days. Nonetheless, the availability of considerable excess capacity in Saudi Arabia and the levels of consuming countries' stockpiles—particularly government stocks—should enable the market to cope with all but the most severe disruption. [redacted]

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The Capacity Issue

The Iran-Iraq war has focused attention on the availability of excess oil-productive capacity to offset a disruption in the Persian Gulf. The question of how quickly this spare capacity can be brought back into production in response to an emergency remains a key concern. The sooner alternative supplies are made available during a disruption, the lower the probability of a runup in oil prices. [redacted]

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Many elements influence the response time, such as the procedures used to shut in capacity, the level of maintenance performed, and other technical as well as financial and manpower considerations. Also, a decision by a producing country to raise output will be affected by perceptions of the scope and probable length of the disruption, and possibly by political considerations. Many producers have not produced near capacity levels for years and could not return surplus capacity to production without a significant leadtime. Judging from reporting from US embassies [redacted] less than half the surplus capacity in key oil producers outside the Persian Gulf would be available within 30 days. [redacted]

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Distribution of Excess Capacity

According to our projections, the already large share of excess capacity concentrated in the Persian Gulf will increase in the fourth quarter. Gulf countries will account for 4.6 million b/d of the 6.9 million b/d of surplus capacity available within 90 days—double the excess capacity outside the Gulf. Saudi Arabia alone will account for 2.8 million b/d of spare capacity, or 40 percent of the total surplus available worldwide. [redacted]

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Outside the Persian Gulf, Libya and Nigeria with 600,000 b/d each and Venezuela with 500,000 b/d account for the lion's share of the 2.3 million-b/d excess capacity that could be available in a 90-day period. Algeria and the United States with 200,000 b/d each and Indonesia and Mexico with 100,000 b/d each account for the remainder. [redacted]

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30-Day Availability

The anticipated rise in fourth-quarter demand will use up much of the spare capacity available within a 30-day period, since producers are likely to increase production from areas that are most accessible. According to our projections and reporting

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from US Embassy sources Libya, Nigeria, and Venezuela would be able to bring only 800,000 b/d on line within 30 days in the fourth quarter. Of this, Libya will have 400,000 b/d, Nigeria 300,000 b/d, and Venezuela 100,000 b/d. We have no indication how much of the remaining surplus capacity outside the Persian Gulf—in Algeria, the United States, and Indonesia—could be available in 30 days. 25X1

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[redacted]

Nigeria could immediately increase production to 1.9 million b/d, according to a mid-June assessment by the US Embassy in Lagos; however, higher output would require three months. Because we project Nigerian production to rise sharply to about 1.6 million b/d in the fourth quarter, 30-day surplus capacity will slip to 300,000 b/d. This projection assumes that Nigeria will be producing 300,000 b/d beyond its OPEC quota. [redacted] 25X1

Venezuela can only bring an additional 100,000 b/d on stream very quickly, according to information recently obtained from the state oil company by the US Embassy in Caracas. Venezuela's remaining spare capacity consists of heavy crudes, much of which has been shut in for over a year, and which requires more startup time. Since we do not expect Venezuelan output to rise appreciably in the fourth quarter from recent levels of about 1.8 million b/d, the full 100,000 b/d should still be available. [redacted] 25X1

Mexico could immediately increase its production by 100,000 b/d if circumstances warranted, according to a statement by the director of PEMEX in late June to US Embassy representatives. Additional output would require costly investment and take three to five months to bring on line, according to the director. Because we expect Mexico to use this immediately available capacity in the fourth quarter, no additional output probably would be available on a 30-day basis. [redacted] 25X1

Other countries outside the Persian Gulf with spare productive capacity—Algeria, the United States, and Indonesia—have a total of 500,000 b/d that could be available with a 90-day leadtime, according to fourth-quarter projections. The availability of any of this capacity within 30 days is not known. On balance, however, it seems reasonable to use 1 million b/d as the best estimate for total spare capacity outside the Persian Gulf that could be brought on line within 30 days in the fourth quarter. [redacted] 25X1

[redacted]

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Conditions for a Rapid Response

The technical capability to raise output with a 30-day leadtime does not ensure availability. First, a producer has to be persuaded that its interests are served by increasing production. Perceptions that a disruption will be too short to warrant investment in reopening shut-in capacity or that greater revenues can be garnered by first letting prices rise can make producers reluctant to forge ahead. Political considerations can also come into play. For example, Libya might be loath to help bail out Western countries if Iran precipitates a major disruption. [redacted]

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Reopening unused capacity rapidly also hinges on technical factors. The leadtime depends heavily upon the manner in which capacity has been shut in. In some cases, wells are kept in production but volumes are reduced by choke valves. In other cases, production is rotated among different sets of wells every few days or so. Such rotation prevents crude oil with corrosive contaminants from sitting in well lines too long. In both cases, production should be able to be restored well within 30 days.

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Fields or sections of fields also are periodically shut in for well workovers and other maintenance. While such maintenance can frequently require more than 30 days, areas are continually being returned to production while others are being shut in. By postponing maintenance in new areas, a net gain in available productive capacity can be realized almost immediately.

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Facilities shut in for long periods require longer leadtimes to restore to production. Such facilities—including well lines, pumps, stabilizers, and gas-oil separation vessels—are often drained of corrosive crude and sometimes refilled with a noncorrosive fluid. This equipment must be drained and, in some cases, tested before returning to operation. The leadtime required would depend on manpower availability and the level of maintenance performed during downtime.

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In extreme cases, wells are plugged with cement and surface facilities are removed for use elsewhere. Iran has shut in much of its capacity in this manner both because of lower production targets and to reduce the vulnerability of some areas to war damage. Plugged wells must be redrilled before they can be brought back on line, and can take nearly as long as new wells, depending on the accessibility and condition of surface facilities. Even after considering all these factors, our estimate of the surplus available is only an indication because the total capacity of an oil system can never be known until it is tested.

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Outlook

Although demand growth in the fourth quarter will reduce spare oil-productive capacity, our judgments concerning the vulnerability of the oil market to a major disruption in the near term remain much the same as at midyear. A Persian Gulf disruption not involving Saudi Arabia—for example, a cutoff of exports from Iran, Iraq, and Kuwait affecting less than 4 million b/d—still could be easily offset by other Gulf and non-Gulf producers and stock draws. If Saudi shipments through the Gulf are also interrupted—a low probability in our view—capacity elsewhere could not offset the loss, and stock draws could not be depended upon to avoid price increases.

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Tunisia: Dealing With Disparities [redacted]

A prolonged period of economic development during the 1970s and the highest adult-literacy rate in North Africa—62.5 percent—created rising popular expectations that Tunis has been increasingly unable to satisfy. The bread riots in January—ignited by government-subsidy cuts—are a dramatic example of strains in Tunisian society. Particularly ominous for the government are the widening gap in urban and rural living standards and the increased alienation of the country's youth. [redacted]

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Social and Regional Problems

The riots first erupted in the rural southern Tunisian towns, where the rise in living standards over the past decade has lagged that in Tunis and the cities of the *sahel,* the eastern coastal area. The coastal cities have benefited from the development of tourism, commerce, and the oil industry, while the south and west have suffered from the government's neglect of agriculture. About one-third of the adult males in rural areas are unemployed. Average income in the south is as much as 40 percent below that of the *sahel* and Tunis. [redacted]

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This economic imbalance between the coastal cities and the hinterland has prompted a growing migration to urban areas. Over half the population now lives in urban areas compared with only 36 percent in 1960. Being unskilled, rural migrants often remain unemployed or restricted to menial labor. Migrants were among the rioters in Tunis, and they remain a pool of idle, disillusioned poor who could again vent their frustration in violence. [redacted]

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Political and generational differences exacerbate regional economic disparities. President Bourguiba's secular, pro-Western government is dominated by individuals from the francophone coastal cities and has little popularity in the south, where French influence is weaker than along the coast. Moreover, the regime has not forgiven the south for supporting Salah Ben Youssef, a pan-Arabist rival of Bourguiba in the 1950s. About 70 percent of all Tunisians are under 26, and this group is hard hit by unemployment. Even college graduates often cannot find employment commensurate with their education, breeding further frustration and cynicism. The Embassy reports that Tunisian youth regard the President with indifference, Prime Minister Mzali with contempt, and government officials as corrupt. Few of the young join the ruling Destourian Party, but many are attracted by the Islamic fundamentalists. [redacted]

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Economic Problems Mount

Until now, political stability under President Bourguiba allowed the government to pursue a flexible, pragmatic approach to economic management. The economy began to sour in the late 1970s, when Tunisia's main sources of foreign exchange earnings—petroleum, tourism, phosphates, and worker remittances—languished as a result of the international recession. Real GDP growth has averaged 3.7 percent since 1979—only half the level of the previous four years, [redacted] Austerity measures were implemented in 1983 to cope with poor economic performance and dwindling revenues. Poor grain harvests and the soft oil market continue to frustrate government efforts to right the economy. [redacted]

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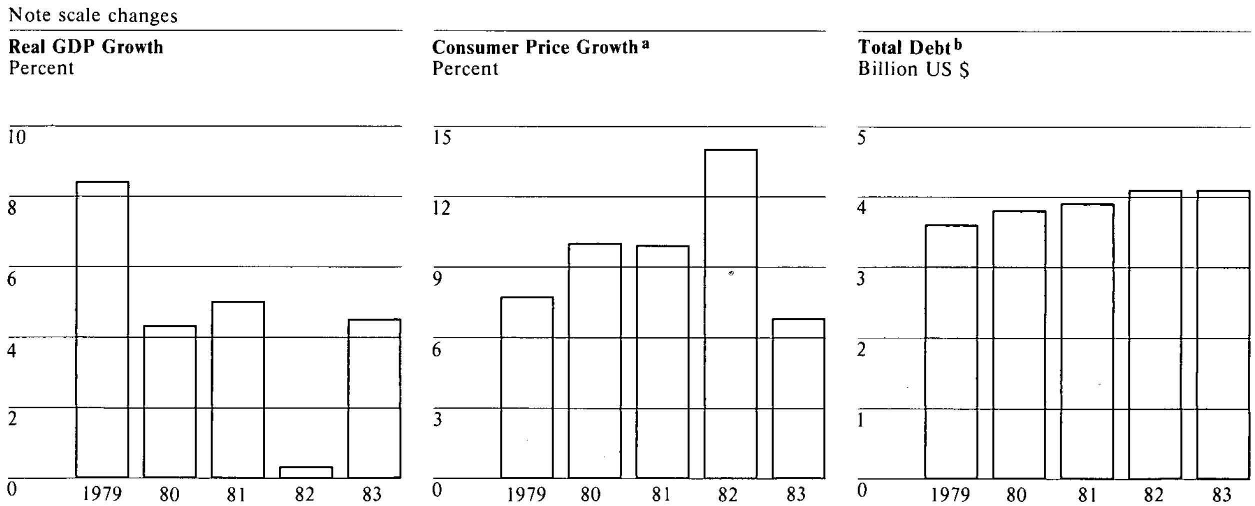
Petroleum is a mainstay of the economy, accounting for 53 percent of export earnings, about 21 percent of government revenues, and 16 percent of

Tunisia: Economic Indicators, 1979-83



[a] Official figures.
[b] Including public and private, guaranteed and nonguaranteed debt.

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GDP. We estimate, however, that production peaked at 120,000 b/d and is currently 114,000 b/d. Declining reservoir pressures and problems with secondary recovery technology in the main oilfields—El Borma and Ashtart—will cause production from these fields to continue to decline. Production from fields still under development should allow overall oil production to remain near current levels for several years, but the US Embassy estimates that the rapid growth in domestic consumption will cut into net oil export volume. Tunisia could become a net oil importer by the end of this decade, according to industry estimates. 25X1

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The boundary dispute and political tensions between Tunisia and Libya have been major obstacles to development of promising offshore fields. Tunis has yet to accept the International Court of Justice ruling delimiting the offshore boundary between these two states. 25X1

Our estimates indicate that declining tourism and worker remittances partially offset the marginal improvement in the trade balance last year. The 1983 current account deficit of $630 million showed little improvement over the 1982 level and probably will jump by close to 60 percent this year. foreign exchange reserves have been drawn down by 36 percent since the end of 1983 and now cover less than one and a half months of imports. 25X1

Budget problems have reached troubling proportions as the government attempts to maintain development and social spending in a period of stagnant revenues. Efforts to trim expensive food subsidies triggered the national riots in January. The US Embassy estimates that Bourguiba's subsequent decision to rescind subsidy cuts has added $140 million to direct budget outlays this year, in addition to the heavy indirect cost of extensive riot-caused damage. 25X1

Tunisia: Current Account Balance *Million US $*

	1980	1981	1982	1983	1984 [a]
Current account	**−443**	**−489**	**−691**	**−634**	**−1,009**
Trade balance	−1,078	−1,070	−1,292	−1,182	−1,510
Exports (f.o.b.)	1,804	2,110	1,625	1,574	1,490
Petroleum	1,345	1,308	910	835	770
Imports (f.o.b.)	2,882	3,180	2,917	2,756	3,000
Foodstuffs	390	428	357	425	395
Services (net)	620	563	560	531	486
Of which:					
Receipts from tourism	640	598	575	553	540
Worker remittances	320	360	372	345	320
Interest payments on external debt	184	210	204	191	205
Private transfers (net)	15	18	41	17	15

[a] Estimated.

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[redacted]

Inability to keep the budget under control is fueling a steady rise in foreign borrowing. Tunisia's total external debt is an estimated $4.4 billion, and repayments consume about one-fourth of receipts from exports of goods and services. Embassy sources state that the prospect of a rapidly rising debt service burden is prompting some officials to explore the need for debt relief over the next several years. [redacted]

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Economic growth has been insufficient to absorb the 3.8-percent annual increase in the nation's labor force. In addition, declining demand for foreign labor in Europe and wealthy Arab states—a traditional release valve for excess Tunisian labor—has helped push unemployment and underemployment to 20 percent in urban areas, according to official Tunisian estimates. We believe, however, that the actual level of unemployment is at least 30 percent. [redacted]

The government has purchased labor tranquillity at a high cost with wage and price policies that have significantly increased real incomes. As a result, labor has come to expect major annual pay increases. Recent wage hikes should help to contain worker demands over the next six months, but we believe that the government will be increasingly hard pressed to walk the line between fiscal prudence and wage demands over the next several years. [redacted]

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[redacted] studies show that agriculture remains an economic bottleneck. Neglect and pricing policies favoring imported grain over domestic production have led to poor performance in this sector. Agriculture employs one-third of the population but accounts for only 15 percent of GDP. We expect that increases in agricultural output probably will lag population growth during the next several years. Food imports, which already meet about 50 percent of demand, will rise further. [redacted]

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Political Dynamics

Tunisia's pressing social and economic problems are compounded by the 82-year-old President's chronic health problems. He is spending less time directing public policy, and his political acumen has dulled considerably. For example, the US Embassy reports that Bourguiba removed the bread subsidies because he believed people were throwing bread away. In addition, Bourguiba refuses to allow the honest elections desired by many Tunisians. [redacted]

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According to press reports, Prime Minister Mzali's interest in rural development has been sidetracked by his ambitions to be Bourguiba's successor. In our view, government infighting and Mzali's lack of popularity stymie reform and are fast dissipating the regime's moral authority. Following the riots, Mzali ousted from the Cabinet his political rival Interior Minister Guiga, assumed his portfolio, and

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orchestrated an official investigation that blamed Guiga for the riots. Nonetheless, Mzali's public standing has not recovered from Bourguiba's reinstatement of the bread subsidies just days after Mzali's public defense of their removal. 25X1

Outlook

We believe that Tunisia's financial position will continue to deteriorate for the rest of the decade. Oil revenues will decline as export volumes fall—especially if real energy prices fail to rebound. Worker remittances—which supplied $345 million in foreign exchange in 1983—will probably decline because of greatly reduced labor emigration. Government efforts to boost exports of Tunisian textiles and agricultural products will encounter problems with quotas in Western Europe. With aid prospects weak, substantial international borrowing will be necessary. A rapidly mounting debt service burden will limit the government's ability to finance improvements in the standard of living. 25X1

We believe that pressure from organized labor to maintain consumer subsidies will frustrate government efforts to keep spending in line with revenue. We estimate that subsidies will equal almost four percent of GDP this year. Public reaction to recent subsidy reductions has been subdued, but we expect that pending upward adjustments on price-controlled goods probably will generate labor and consumer unrest. Radical elements in Tunisian society, particularly Islamic fundamentalists, may try to organize or use antigovernment demonstrations to force concessions from the regime. 25X1

The US Embassy in Tunis believes that the government's inability to trim subsidies will hamper Prime Minister Mzali's ability to balance the expectations of Tunisia's burgeoning population, military modernization goals, and dwindling domestic resources. The gap between consumption and production of foodstuffs will increase unless politically sensitive food subsidies are trimmed and price controls are eliminated. This, however, would again push inflation to double-digit levels. 25X1

The government would be more pressed than it was last January if widespread unrest recurred and will increasingly rely on repression to remain in power. Bourguiba's death almost certainly will aggravate the situation, especially if the unpopular Mzali assumes the presidency. 25X1

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India: Gandhi's Election-Year Economics

Prime Minister Gandhi is trying to keep economic issues from becoming a major theme in the national elections, which must be held by January 1985. Her goals, in our judgment, are to hold down prices of key commodities and to limit unemployment in the preelection months. She has also moved to obtain the support of key groups and acquire campaign funds for her Congress (I) Party. Several programs initiated during the past year have a populist slant but probably do not presage a leftward shift in Gandhi's policies if she wins the election.

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Anti-Inflation Moves

Gandhi has moved strongly during the past year to control the prices of a few key consumer goods and ensure their availability:

- The government authorized an increase in domestic sales from government-owned stocks of sugar, even though adequate supplies of higher priced or lower quality sugar were available on the open market. This required the government to import sugar.
- Despite record rice production in 1983/84, New Delhi arranged for a sharp increase in rice imports. Some imports were probably necessary to rebuild government stocks that had been depleted during the 1982/83 drought, and Gandhi may have been concerned that security problems in the Punjab would curtail the current crop. The decision to import rice, however, was in part designed to influence voters in southern states, where consumers prefer rice to less expensive, but abundant, wheat.
- New Delhi banned, for several months in early 1984, exports of tea varieties consumed by low-income voters, and renewed restrictions in September. Tea exporters contend that curbs reflect election-year politics even though New Delhi has traditionally sacrificed a foreign exchange windfall rather than risk a rapid rise in agricultural prices at home.
- New Delhi also plans to import a larger quantity of edible oil in 1984 despite rising world prices and increased production.

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Gandhi, however, has tolerated price hikes that are less visible to consumers. During the past year, she permitted an increase in government-monitored prices of key industrial goods such as coal and steel, and raised import duties on most commodities. New Delhi left the internal prices of petroleum products unchanged even though oil import prices fell.

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Other Populist Measures

Several policy moves reflected Gandhi's interest in limiting unemployment—and thus enhancing her public image as an advocate for the poor. In August 1983 she announced two new programs—a supplementary rural employment scheme for landless laborers, and a more limited program to provide self-employment among educated youth. In October 1983 the central government took over the management of 13 Bombay textile mills shut down by an extended strike—but did not seek a job-rescue effort for jute mill workers in the state of

West Bengal, which is governed by an opposition political party. More recently, Gandhi ordered restructuring of guidelines for India's next five-year plan to give more emphasis to employment and poverty programs. 25X1

Since last January, the Congress (I) has organized mass meetings in several parts of the country, at which commercial banks distributed small loans. According to press reports, the Deputy Finance Minister threatened to punish commercial bank officials who refused to cooperate in lending to borrowers identified by party workers. While addressing a meeting of low-caste groups, Gandhi even asked why banks could not write off loans to the poor. In our view, many borrowers will expect to repay loans obtained at these rallies in votes, not money. 25X1

Favors for Other Groups

Gandhi has also adjusted policy to appease the middle classes. The February 1984 central government budget reduced income tax rates and raised the ceiling on salaries and benefits that private corporations may pay their managers. In an earlier effort to stimulate the electronics industry and benefit consumers, Gandhi lowered excise taxes on goods such as TV sets and reduced import duties on electronic components; press reports speculate that she hopes to expand audiences for government-controlled programing. 25X1

We suspect an increase in political tampering with administrative decisions during the past year in order to swing votes in key areas. Press reports allege, for example, that the Railway Minister has changed the location of some projects to favor his hometown. The proposed route for a $1.5 billion natural gas pipeline has been revised to speed construction of a fertilizer plant near the constituency of Gandhi's son. Some private businessmen who inquired about delays in obtaining licenses to establish plants were reportedly told to change the proposed location of their factories. 25X1

Gandhi has exploited government authority over economic activity to obtain campaign funds for her party. Changes in purchasing procedures and suppliers suggest political intervention in a large grain import contract last year. Press reports speculate that central government intervention in a major corporate takeover bid was prompted in part by Gandhi's interest in supporting a businessman who is alleged to arrange payoffs on foreign contracts. Disgusted Indian businessmen frequently complain that corruption has been on the rise. 25X1

Limited Impact on Economic Liberalization

Efforts to ease bureaucratic controls on industry and foreign trade stalled during the past year while officials were preoccupied with the forthcoming election and with major internal problems such as violence in the Punjab. Gandhi's policy advisers may have been especially reluctant to expose her to opposition party charges that Gandhi is pro-business or to business complaints about increased competition. Even in a nonelection year, however, we believe Gandhi might have postponed major economic initiatives until the benefits from earlier liberalization efforts and the severity of forthcoming foreign exchange constraints become clear. 25X1

Role of the Opposition

In our judgment, both Gandhi and the fragmented opposition see much more voter appeal in jobs and prices in the local market than in national economic strategy. Most opposition parties have few firm views about alternative policy approaches and could not agree among themselves if they did. A January 1984 meeting of several regional and left-of-center parties called for a total restructuring of central government economic policies, but proposed nothing that Gandhi herself does not favor. 25X1

Leaders of regional and Communist parties still accuse Gandhi of unwarranted centralization of power and interference in state government affairs. They complained bitterly when she postponed a reallocation of taxes and grants distributed by the central government, thus depriving the leftist government of West Bengal of additional revenue during preelection months. As the election heats up, however, opposition parties have emphasized Gandhi's political sins—moves to oust state leaders, for example—rather than her economic measures.

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Economic Impact of Gandhi's Policies

Gandhi's efforts to enhance her election prospects through economic policies have placed additional but manageable strains on India's budget and foreign payments position. India can temporarily afford agricultural imports to please consumers. The revenue loss from income tax concessions is negligible. Even Gandhi's employment schemes, however ill designed and politically motivated, at least address real economic needs. In the longer run, the massive interference of the Congress (I) in lending programs may prove the most irresponsible of Gandhi's innovations; it not only generates bad loans but also encourages blatant abuse of the commercial banking system.

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Gandhi has probably not succeeded in removing economic issues from the campaign. Domestic prices of tea and unrefined sugar are still rising. Farmers perennially demand higher prices for their crops and are even more vociferous in an election year. Government employment schemes are too small to have a major impact on job opportunities for the vast Indian labor force. Even Gandhi's efforts to buy votes and obtain campaign funds could backfire; a recent opinion survey in northern India indicates strong resentment of corruption. Nevertheless, Gandhi's policy moves—and two years of good weather—have probably helped contain prices and unemployment and advance her election prospects.

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Gandhi's coddling of consumers probably will not last beyond the elections. Public statements of senior officials, and of Gandhi herself when not electioneering, show increasing concern about shortages of foreign exchange and government revenue. Hence, we doubt that any new government would continue to splurge on imports. Guidelines for the next five-year plan suggest a new emphasis on employment, but through more intensive use of agricultural land and industrial plants as well as government job programs.

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